Research Update:

JSL S.A. Outlook Revised To Positive On Increasing Scale And Deleveraging; 'B+' Global Scale Rating Affirmed

September 24, 2021

Rating Action Overview

- Brazilian transportation company, JSL S.A., delivered solid growth through acquisitions over the past few quarters, leading to about 50% revenue growth in 2021 (pro forma acquisitions), and should continue to do so afterwards.
- With synergies of integrated assets and the gradual recovery of the Brazilian economy, we expect the company's EBITDA to surge to close to R$850 million in 2022 from R$510 million in 2020.
- On Sept. 24, 2021, S&P Global Ratings revised the outlook on its ratings on JSL to positive from stable, and affirmed its 'B+' global scale and 'brAA' national scale ratings.
- The positive outlook reflects our expectation that the company will continue to gain scale and diversification, strengthening its business, while improving credit metrics, reducing leverage comfortably below 4.0x by the end of 2022.

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Rating Action Rationale

M&As to increase scale and diversification. Since the company went through the corporate reorganization and the IPO last year, it has been gaining scale through internal, and mostly acquisition-based, growth. The company completed five acquisitions in the past 12 months that enabled JSL enter into new business segments and types of services, such as compressed gas, frozen and refrigerated cargo, and warehouse management. Such growth also broadened the company's geographic diversification, with a larger presence in the northeastern region of Brazil and expanding its operations to other countries in South America. We also factor in our analysis synergy growth among the acquired companies, given the higher bargaining power of the parent, the Simpar group, in acquiring new vehicles at lower costs and at a faster pace amid the current delays in the automaking segment, given supply chain issues, namely the lack of semiconductors. As a result, excluding potentially additional acquisitions, we expect JSL to post consolidated revenue above R$5 billion in 2022, compared with R$2.8 billion in 2020. We also expect EBITDA close to R$850 million next year, sharply up from R$510 million in 2020 (considering pro forma, 12-month operations of acquired companies last year).

The company to deleverage over the next few years, assuming conservative shareholders' remuneration strategy. Given JSL's public target to reach gross revenue above R$11 billion in 2025, it aims to use most of its operating cash flows for acquisitions or investments in its business. The recently acquired assets have low leverage and solid profitability, and should accelerate JSL's deleveraging with EBITDA increasing from consolidated organic growth that wouldn't require additional debt. Our current base-case scenario assumes relatively stable gross debt levels over the next few years, R$3.0 billion - R$3.5 billion, and adjusted net debt close to R$3.0 billion, which includes the future payments for these acquisitions. We believe JSL would maintain debt to EBITDA at 3.0x-3.5x, with increasing EBITDA and modest debt increases. We don't consider any new acquisitions in our forecast, given the uncertainties about timing, size, and amounts. Still, we believe M&As will strengthen the company's credit quality, if accompanied by relatively stable leverage levels.

Business diversification and larger scale mitigate some residual effects of the pandemic and cost pressures. JSL's automotive operations are still facing lower activity this year than prior to the pandemic, given the supply chain problems in that industry. Still, the company's increasing diversification and higher share of revenue coming from more resilient sectors, such as food and beverages (currently about 22% of total revenue), mitigate the risks of prolonged downturns in some industries. JSL has also been facing cost pressures this year on various fronts, such as fuel, auto parts, and wages. But we believe its larger scale and long-term relationship with customers will allow the company to continue renegotiating contracts, passing through most of the cost increases to maintain adequate profitability.

Outlook

The positive outlook indicates a one-in-three chance of an upgrade in the next 12-18 months due to our expectation that JSL will continue to deliver substantial revenue growth and increasing cash flows over the next few years through acquisitions and internal growth, gradually improving credit metrics. We don't incorporate new acquisitions in our base case-scenario, but we believe these will likely occur in the short term, which could support even faster improvement in metrics if acquired companies have lower leverage than JSL, including the acquisition payments.

Upside scenario

We could raise the ratings in the next 12-18 months if the company's growth materializes in line with our expectations, leading to greater scale, revenue base, and EBITDA. We expect EBITDA of more than R$800 million in 2022 and close to R$1 billion in 2023, only considering its current operations. For an upgrade, we would expect JSL to maintain debt to EBITDA consistently below 4.0x and funds from operations (FFO) to debt above 12%.

Downside scenario

We could revise the outlook to stable if the company's growth doesn't materialize or if it incurs additional debt that would raise debt to EBITDA well above 4.0x and reduce FFO to debt close to or below 12%. A downgrade is unlikely at this point because it would require a drop in JSL's stand-alone credit profile (SACP) and a downgrade of its parent company, Simpar. If we were to downgrade Simpar to 'B+', ratings on JSL wouldn't change because its SACP would be at the same level as the group credit profile. And if we were to revise downwards JSL's SACP to 'b', assuming no change in Simpar's credit quality, the final rating on JSL would still be 'B+' due to expected support from the higher rated parent.

Company Description

JSL is the main provider of logistics services and freight transportation in Brazil. The company provides services to about 16 sectors with no significant revenues concentration. Its portfolio consists of asset-light and asset-heavy contracts, accounting for 65% and 35% of revenue, respectively. We expect the company to post net revenue of more than R$4 billion and EBITDA close to R$700 million in 2021. JSL is a subsidiary of the Brazilian transportation group, Simpar S.A. (global scale: BB-/Stable/--, national scale: brAA+/Stable/--), which owns 74% of the company. We expect JSL to contribute about 30% and 20% of the group's total revenue and EBITDA, respectively, in 2021.

Our Base-Case Scenario

- Brazil's GDP growth of 4.7% in 2021 and about 2% afterwards.
- Inflation of 7% in 2021, 4.4% in 2022, affecting costs, along with contract prices and rates on existing contracts, due to clauses that allow for inflation pass-through;
- Revenue increasing about 50% in 2021 due to recent M&As and economic recovery fostering a significant growth in the segment.
- Revenue and EBITDA increasing 20%-25% in 2022 with new contracts already signed--mainly JSL and Fadel--as well as a recovery in Transmoreno activities (automotive logistics) linked to the industry's likely recovery.
- The company's cost structure shows asset-light flexibility with some exposure to fixed costs, which should allow for some improvement in gross margins. We expect JSL to improve its margins thanks to stronger margins at the acquired companies and higher synergies, which are mainly in the vehicle purchase costs.
- Cash outflows for the already signed acquisitions of R$396 million in 2021 and R$185 million in 2022.
- Net capital expenditures (capex) for 2021 of R$550 million – R$600 million and R$300 million – R$350 million for 2022, incorporating contract renewals.
- Dividend distribution of 25% of previous-year net income.

Key metrics

Table 1

JSL S.A.--Key Metrics*

	2020a	2021e	2022f	2023f
(Mil. R$)				
Revenue	2,827	4,200-4,400	5,000-5,500	5,400-6,000
EBITDA	511	~700	800-900	900-1,000
EBITDA margin (%)	18.1	15-17	15-18	15-18
Funds from operations (FFO)	250	350-400	400-450	450-500
Debt	2,271	~3.000	~3.000	~3.000
Debt to EBITDA (x)	4.4	4-4.5	3.3-3.8	3.0-3.5
FFO to debt (%)	11.0	12-14	13-15	15-18

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast. **2020 figures are not fully comparable given the corporate reorganization during that year. We made adjustments to try to reflect pro-forma figures of JSL's operations.

Liquidity

We view JSL's liquidity as adequate, with sources of cash exceeding uses comfortably by more than 1.2x for the next 12 months and remaining positive even if EBITDA were to decline 15%. We expect the company to continue relying on its ability to access external funding to support its growth strategy. Moreover, we expect JSL to maintain a much higher cash balance than its short-term debt exposure.

Principal Liquidity Sources

- Cash and cash equivalents of R$665.6 million as of June 30, 2021;
- Committed credit line of R$200 million; and
- Expected FFO of about R$386.5 million in the next 12 months

Principal Liquidity Uses

- Short-term debt of R$56.1 million as of June 30, 2021;
- Acquisition payments in the short-term totaling R$145 million;
- Net capex of R$295 million in the next 12 months; and
- Dividends distribution of about R$12 million.

Covenants

JSL has the following debt payment acceleration covenants on its local debentures and CRA issuance:

- Net debt to EBITDA-A of maximum of 3.5x; and
- EBITDA-A to net interest at a minimum of 2.0x, where EBITDA-A is EBITDA plus the residual accounting cost from the sale of assets.

Although the cushion until December 2021 might be a little below 15%, we expect it to be about 30% going forward.

Group Influence

We view JSL as a highly strategic subsidiary of Simpar. We expect JSL to benefit from the group's long-term commitment as the subsidiary represents a relevant portion of consolidated EBITDA. Therefore, JSL is likely to receive support during stressed conditions.

Ratings Score Snapshot

Issuer credit rating:

- Global scale: B+/Positive/--
- National scale: brAA/Positive/--

Business risk: Fair

- Country risk: Moderately high
- Industry risk: Intermediate
- Competitive position: Fair

Financial risk: Aggressive

- Cash flow/Leverage: Aggressive

Anchor: bb-

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Negative (-1 notch)

Stand-alone credit profile: b+

Group credit profile: bb-

Entity status within group: Highly strategic

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018

- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
JSL S.A.		
Issuer Credit Rating	B+/Positive/--	B+/Stable/--
Brazil National Scale	brAA/Positive/--	brAA/Stable/--

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